

Message Text

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C O N F I D E N T I A L TOKYO 8482

LIMDIS GREENBACK

FOR WIDMAN FROM ESCOUBE

E. O. 11652: GDS

TAGS: EFIN, C-20, JA

SUBJ: DEFINITION OF RESERVES FOR C-20 VIEWED AGAINST
JAPAN'S RESERVE MANAGEMENT PRACTICES

SUMMARY: FOLLOWING ARE FINATT'S COMMENTS ON TREASURY/ FRB
STAFF PAPER FOR C-20 ON DEFINITION OF RESERVES VIEWED
AGAINST JAPAN'S RESERVE MANAGEMENT PRACTICES.

1. STAFF PAPER, WHICH IS TO BE USED IN CONJUNCTION WITH
RESERVE INDICATOR MECHANISM, IS BASED ON BALANCE SHEET
RATHER THAN FLOW APPROACH. PRIME OBJECTIVE SHOULD BE TO
PREVENT RESERVE INDICATOR MECHANISM FROM BEING FRUSTRATED
AND BECOMING INOPERATIVE BECAUSE OF INADEQUACIES OF DEFINI-
TION OF RESERVES. IF NARROW DEFINITION OF RESERVE ASSETS
ADOPTED AS PROPOSED IN STAFF PAPER, THEN SYSTEM WILL
PROBABLY HAVE TO OPERATE UNDER CONDITIONS WHEREBY
COUNTRIES COULD " HIDE RESERVES" IN VERY SUB-
STANTIAL AMOUNTS. TOKYO 6197 REPORTED JAPANESE PRACTICES
OF SWITCHING FROM ASSETS NOW CONSIDERED AS RESERVES INTO
NON- RESERVE TYPE ASSETS. SECOND OBJECTIVE OF DEFINITION
SHOULD ALSO PRECLUDE SUBSTITUTION OF ASSETS BETWEEN
" OFFICIAL" AND " NON- OFFICIAL" HOLDERS. QUESTION OF WHETHER
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RESERVES SHOULD ONLY INCLUDE MOBILIZABLE ASSETS
SEEMS MUCH LESS RELEVANT.

2. FINATT' S VIEW BASED ON RECENT JAPANESE EXPERIENCE BUT ALSO THAT OF OTHER OECD COUNTRIES. SUGGESTS A RESTRICTED LIST OF ASSETS (AND LIABILITIES) CREATES VERY SERIOUS POTENTIAL FOR SUBSTITUTION BETWEEN ASSETS AND MIGHT ACCELERATE OFFICIAL WINDOW DRESSING OPERATIONS. THIS WOULD ALSO ACCELERATE GROWTH OF PRIVATE FOREX LIQUIDITY WHICH IN TURN COULD CREATE RESERVE PROBLEMS FOR THIRD COUNTRIES. ULTIMATELY RESPONSIBILITY FOR ADJUSTMENT MIGHT BECOME DIFFICULT TO ASSIGN. IF THIRD COUNTRY GAINED RESERVES BUT ANOTHER COUNTRY WERE THE GENERATOR OF LARGE CAPITAL FLOWS, FOR EXAMPLE. CONSEQUENTLY FINATT BELIEVES BROADEST DEFINITION OF ASSET RANGE LESS LIKELY TO FRUSTRATE SYSTEM BY KINDS OS SUBSTITUTION ALREADY BEING PRACTICED.

3. ASSETS SHOULD INCLUDE SPOT AND FORWARD CLAIMS ON NON-RESIDENTS HELD BY GOVT AS WELL AS GOVTAAOWNED OR CONTROLLED AGEN-
CIES
DENOMINATED IN BOTH DOMESTIC AND FOREIGN CURRENCIES. SUCH DE-
FINITION WOULD PREVENT SHIFT OF RESERVES EITHER INTO OFFICIAL
EXPORT CREDITS OR THROUGH JAPAN' S FOREIGN CURRENCY LOAN SYSTEM.
ASSETS SHOULD ALSO INCLUDE SPOT AND FORWARD CLAIMS ON DOMESTIC
RESIDENTS DENOMINATED IN FOREIGN CURRENCIES IN ORDER TO
PREVENT SWITCH IN OWNERSHIP OF FOREX FROM OFFICIAL TO
DOMESTIC BANKING OR OTHER PRIVATE INDUSTRY. UNDER THIS
DEFINITION GOU' S INVESTMENTS IN NON- U. S. TREASURY
SECURITIES, FOREX DEPOSITS WITH DEPOSIT BANKS, IMPORT
USANCE FINANCING WITH FOREX, AS WELL AS OFFICIAL FORWARD
COVER PROVIDED TO SMALLER BUSINESSES WOULD ALL BE INCLUDED
IN RESERVES.

4. FINATT REALIZES THAT IF NET RESERVE CONCEPT ADOPTED
AND LIABILITIES ARE TO BE DEFINED SYMMETRICALLY, THEN
SERIOUS PROBLEMS OF IDENTIFICATION AND MEASUREMENT WILL
ARISE BY USING BROAD DEFINITION.

5. BROAD DEFINITION SUGGESTED IN PARA 3 ABOVE WOULD NOT
NECESSARILY PREVENT THERE BEING " BORDERLINE" ASSETS.
MOREOVER, SOME COUNTRIES MIGHT HAVE VALID REASONS FOR
OBJECTING TO INCLUSION OF CERTAIN KINDS OF ASSETS WHICH
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NOT PURCHASED FOR WINDOW DRESSING PURPOSES. PERHAPS
WAY TO DEAL WITH THAT WOULD BE TO ESTABLISH SPECIAL COMMITTEE
IN IMF COMPOSED OF STAFF AND DIRECTORS TO REVIEW SPECIFIC
OBJECTIONS TO APPROPRIATENESS OR INAPPROPRIATENESS OF INCLUDING ALL
THE TYPES OF ASSETS IN CALCULATING RESERVE LEVELS. IN CASE OF DIS-
PUTE, HOWEVER, IT WOULD BE UP TO COUNTRY TO DEMONSTRATE TO
COMMITTEE THAT TRANSACTIONS UNDERTAKEN BY MONETARY

AUTHORITIES OR GOVT CONTROLLED AGENCIES DURING PAST QUARTER OR YEAR WERE NOT HAVING ACTUAL OR POTENTIAL IMPACT ON RESERVES AND WOULD NOT PREVENT WARNING SIGNALS FROM BEING SOUNDED NOR CONVERTIBILITY POINTS BEING REACHED. IN ANY CASE IT SEEMS INDISPENSABLE THAT REPORTING SYSTEM OF ASSETS COVER AS COMPREHENSIVE A LIST AS POSSIBLE EVEN THOUGH COMMITTEE MIGHT DECIDE THAT SOME ASSETS SHOULD BE EXCLUDED FROM OFFICIAL RESERVES. ESSENTIAL ASPECT IS TO HVE INFORMATION AT HAND THAT WOLD DETECT OPERATIONS OF WINDOW DRESSING CHARACTER WHICH, IF UNDERTAKEN, WOULD UNDERMINE OPERATION OF INDICATOR MECHANISM.

6. FINATT HAS NOT OBTAINED ANY NEW INFORMATION ON JAPAN' S RESERVE MANAGEMENT PRACTICES OTHER THAN THAT REPORTED IN TOKYO 6197 AND 8241.
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